

POLICY ISSUES AND RECOMMENDATIONS FOR THE COTTON SUBSECTOR IN AFGHANISTAN

A RAMP Agricultural Policy Briefing Paper

Dr. Kenneth Neils

**RAMP Chief Agricultural Economist
Chemonics International Inc.**

Dr. Mohammad Usman

**RAMP Senior Policy Advisor
Chemonics International Inc.**

Kabul, Afghanistan

November 12, 2003

Disclaimer: The views expressed in this paper are solely those of the authors and do not necessarily represent the views of Chemonics International Inc, the U.S. Agency for International Development or the Transitional Islamic State of Afghanistan.

POLICY ISSUES AND RECOMMENDATIONS FOR THE COTTON SUBSECTOR IN AFGHANISTAN

Background

Cotton production in Afghanistan reached 350,000 mt on 188,700 hectares in 1983. In 2003, it is estimated that 30,000 mt of cotton was produced on 46,960 hectares.

In the 1970's and 1980's, lint cotton was used by local textile mills and also exported in quantities that significantly contributed to foreign exchange earnings in Afghanistan. Only a meager quantity of lint cotton was or is expected to be exported in 2003.

By decree, the Government has had, from a legal standpoint, a monopsonistic and a monopolistic role in purchasing, processing, and marketing cotton over the past 60 years. Today, the government owns cotton gins in Kunduz, Helmand, Mazar, and Herat. Only the gins in Helmand (historical capacity over 32,000 mt of seed cotton), Kunduz (historical capacity >100,000 mt), and Mazar (current operating capacity of 12,000 mt) are operating, albeit at very low levels of production (5000 mt, 500 mt, and 370 mt of seed cotton processed in 2002, respectively).

Private gins are operating in some of the main cotton-producing provinces (Helmand, Herat, Kunduz, Takhar, Mazar, and Baghlan) of Afghanistan. In Helmand province alone, 44 cotton gins are operating. According to the Ministry of Light Industry, there are seven government-owned, currently operating, textile factories in Afghanistan. These are located in Kabul (2), Kapisa, Baghlan, Mazar, Kandahar, and Herat. There are no private textile factories. The government's textile machinery is old and the factories are unable to cover their cost of production. The estimated cost of production is Afs 16/meter and the selling price is Afs 8/meter. Neighboring countries have more efficient textile factories. In recent years, the Afghanistan Government factories produced 3.5 million meters of textile cloth and sold only 500,000 meters.

Problems

- 1) The Afghanistan Government bans the private ginning of cotton. However, in 2002, private ginners in Helmand province, for example, purchased and ginned over 6,800 mt of cotton from producers. These private ginners purchased the cotton for Afs 14-17/kg (\$280-\$340/mt) as compared to the government price paid to the producer of Afs 10/kg (\$200/mt).
- 2) Due to the ban, the relatively low prices paid by the Government, and the destruction of irrigation networks, cotton producers and private ginners are reluctant to expand their cotton area planted and invest in additional processing equipment and machinery, respectively.
- 3) In 2002, the Government bought raw cotton at below-market prices from the producers and sold lint cotton, on a much delayed basis, at a price (\$751/mt) established through a tendering process. In 2003, the Government is buying seed cotton from producers at Afs 15/kg (\$300/mt) and has sold lint cotton from previous years at \$944/mt. Government gins are operating in the red at far below capacity

levels. As a result, at the Spinzar gin in Kunduz, the number of employees has been reduced from 580 employees in 2002 to 400 current employees in 2003.

Though the Minister of Agriculture has expressed his interest in allowing private gins to operate, the Ministry of Small Industries and Foodstuffs, which has the greatest influence on the operations of the gins, and the Ministry of Finance, which controls the budget available to the gins, do not appear to be interested in doing so. The justifications for the restrictions on private gins include the allegation that the gins operate as fronts/covers for illicit poppy processing and trade activities, and the political sensitivity of undermining the viability (if there is any) of state-owned enterprises.

Issues

- 1) The potential for production of cotton in Afghanistan is reflected in the production figures reported in 1983. The quality and potential volume of lint cotton produced in Afghanistan is in demand in the international market at prices that are attractive to Afghan producers and ginners. At the current international price (above \$1400/mt), Afghan producers are receiving from the government-owned gins a (delivered to the gin) price of Afs 15/kg (\$300/mt) and realizing an estimated \$200/hectare net profit. However, cotton producers have been planting the same seed cotton available each year from the government gins. The seed has degenerated over the years and improved seed is needed. Private ginners are receiving a competitive price (from exporters in Karachi) for uncleaned lint cotton of about \$990/mt (fob gin) and realizing at least an estimated 20% net profit. About 90% of the seed cotton grown in 2003 is being bought by the private gins in Afghanistan.
- 2) The large capacity and the current operability of the gins in Kunduz and Helmand, in particular, are valuable assets that could, under improved management and much higher capacity utilization, provide the necessary ginning capacity to allow the cotton industry to expand to levels not seen in Afghanistan for over 20 years. The Ministry of Small Industries and Foodstuffs is willing to discuss the selling of its cotton gins with the private sector. The Ministry has allowed a private operator to operate the government gin in Mazar in 2003. The Ministry does not provide any subvention to its cotton gins, however, it does provide interest free loans (on a revolving basis) to the gins for buying seed cotton from producers. Because the assets of the cotton gins are potentially of high value, it is in the best interest of the TISA to have an assessment made of the feasibility of privatization of these assets. There has been some interest shown by the private sector (viz., OLAM International) in providing their own capital to re-furbish one or more gins, and to pay farmers for the seed cotton.
- 3) Convincing the responsible Ministries of the TISA Government to allow private gins to operate is complicated. The Ministry of Small Industries feels that the private ginned cotton is being exported with both opium and arms buried within the lint cotton. If such is the case, unless there is an effective border control system in place to interdict this activity, the Ministry is not willing to lift the ban.
- 4) Marketing of seed and lint cotton requires a transparent grading system that assures (a) the producer and the buyer and (b) the ginner and the exporter a quality-based pricing system and a quality control program that will hold up in the international

marketplace. Policy work in establishing practical grades and standards based on established weights and measures requires the immediate attention of the TISA Government, the donors, and stakeholders within the cotton industry. At the Spinzar gin in Kunduz, a person responsible for grading manually grades (by cotton length, into three available grades) each producer's cotton as it is brought in to the gin to be weighed (see photos). A more transparent grading system is needed, but the system would be market related and not a government function. Producers have not specifically complained about the grade of cotton that has been assigned to their cotton, so a more transparent grading system could be started next year when the potential exists for private sector ownership and management after privatization of the government's cotton gins.

- 5) There are export taxes and incidental (illegal) transport taxes that make exporting Afghanistan-produced cotton less competitive.

Recommendations

- 1) Officially remove the current restrictions on private gin operations. Drug interdiction activities need to include the inspection of lint cotton (from private gins) exported from Afghanistan.
- 2) Improved cotton seed is needed by the cotton producers. The most immediate increase in seed supply can be achieved by enacting a seed law that allows the importation of seeds that meet international seed certification standards. The Ministry of Agriculture and Animal Husbandry should develop a policy to accelerate adaptive research on imported varieties, whether by private, public or public-private partnerships that speed the delivery of improved seeds to farmers.
- 3) Assess the asset value and feasibility of privatizing the government owned cotton gins.
- 4) Remove export taxes and restrictive administrative barriers, and substitute an exporter-friendly licensing system.
- 5) Work within the TISA/donor consultative process to plan cotton and other commercial crop sub-sector interventions to promote productivity, producer and processor services (such as finance, infrastructure improvements), the adoption of quality standards, and the export of Afghan agricultural products to regional and international markets.